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PERFORMANCE IMPROVEMENT REMAINS ELUSIVE FOR MPLI MARKET

by Jim Auden, CFA, and Gerry Glombicki, CPA, ARM

A long-awaited shift to rising premium rates in the U.S. medical professional liability insurance (MPLI) market provides hope for a recovery in segment underwriting performance. However, results continued to deteriorate with a 113% combined ratio (see Table 1) in 2020, the fifth consecutive year of underwriting losses, due partly to fading loss reserve strength and pandemic-related concerns.

Net written premiums in MPLI increased by approximately 4% for the third consecutive year in 2020 despite several companies implementing premium return actions associated with pandemic-related underwriting exposure reductions.

Premium growth will continue and underwriting results will likely show improvement near term, but a return to underwriting profits is doubtful as litigation-related loss-severity pressure persists, and movement to rate adequacy remains inhibited by MPLI market fundamentals.

Weaker Reserves, Elevated Loss Ratios

Poorer underlying MPLI results were masked for several years by recognition of prior-period reserve strength. Calendar-year reserves developed favorably for every year since 2005, with many years' reported development in excess of 20% of annual earned premiums. However, favorable development dropped during the last two years to essentially zero (see Table 2 on Page 6).

Reserve deficiencies have emerged in the last two years in the claims-made MPLI segment (approximately 75% of all MPLI premiums) that is typically coverage for physicians and other healthcare providers. The smaller occurrence (25%) segment, more represented by hospitals and facilities coverage, continues to report annual favorable development.

An extended period of weak pricing, coupled with changing claims severity trends, led to higher accident-year (AY) loss ratios that are also now developing unfavorably as experience matures. The MPLI industry AY loss ratio was 71% in 2011, with the ratio rising substantially to range between 87% and 90% from 2016 through 2020 (see Table 3 on Page 6).

The low-frequency/high-severity nature of MPLI losses creates considerable challenges in projecting ultimate losses. The industry had a long track record of AY loss ratios developing favorably over time, including the 2011 loss ratio improving by 14 percentage points from original estimates. However, years 2016 through 2019 have shifted to moderate adverse development, symptomatic of the erosion of any reserve "cushion" in MPLI. The 2018 loss ratio experienced 3.6 points of adverse development since inception.

Pandemic Adds Loss Projection Challenges

Social and economic disruption due to the COVID-19 pandemic had significant effects on the MPLI market, and uncertainty remains regarding future related litigation in MPLI and several other property/casualty lines.

Reductions in healthcare patient encounters and medical procedures in 2020 lowered underwriting risk exposures and MPLI claims filings. Claims reporting information in statutory financial statements reveal an estimated 14% reduction in claims-made MPLI claims for 2020 versus the previous year. A slow-

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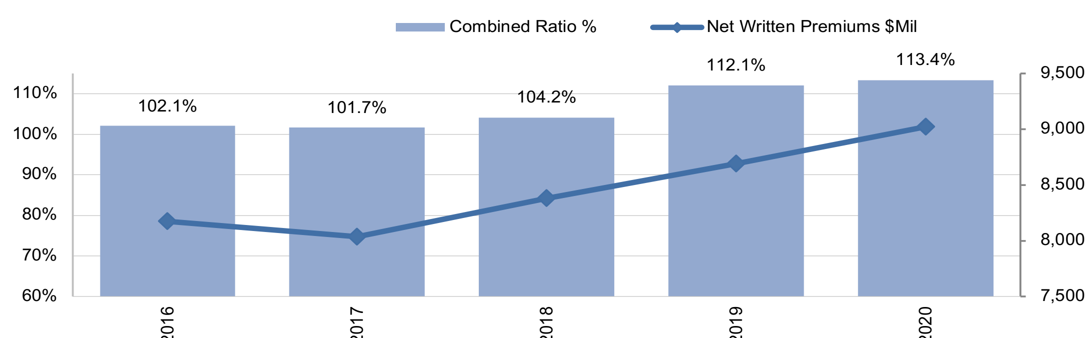
MPLI CALENDAR-YEAR UNDERWRITING RESULTS TABLE 1

Source: S&P Global Market Intelligence, Fitch.



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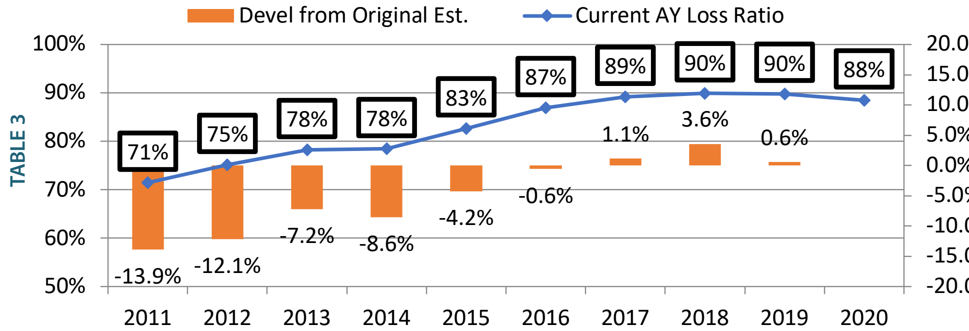
down in the judicial process from court closures contributed to a reduction in claims closures and settlement payments that boosts cash flows.

While the 2020 AY loss ratio remains in the high 80s, actuarial caution in many instances leads to a measured reaction to a positive or negative shift in trend. As effects of the 2020 claims filings reduction unfold into paid losses, there is a greater chance incurred loss estimates for the period will decline over time.

Claims experience in 2021 and beyond will be influenced by the pace of the return to normal economic activity and medical care utilization. The risk of an influx of pandemic-related MPLI claims is mitigated somewhat by state and federal measures to provide immunity for healthcare providers.

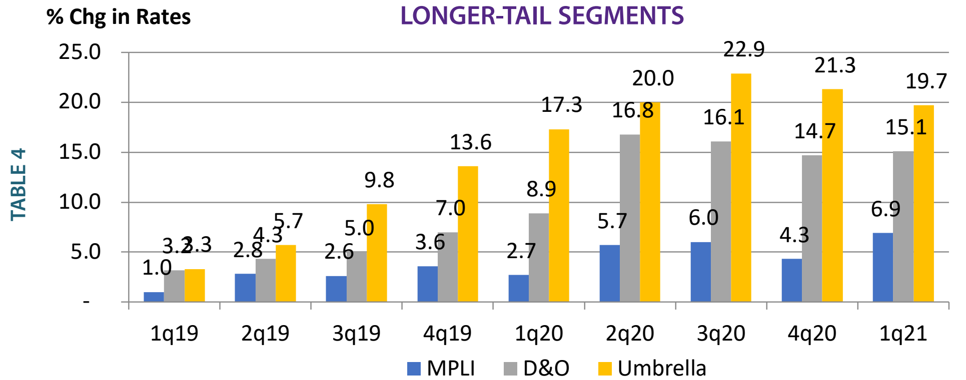
Greater future risk relates to the continuation of higher loss severity and more frequent multi-million dollar jury verdicts. Rising social inflation influenced by changes in social norms, legislation and jury sentiment promote higher claims costs, as does the recent expansion of the litigation finance industry.

MPLI ACCIDENT-YEAR LOSS & LAE RATIOS



Source: S&P Market Intelligence, Fitch MPLI Claims Made & Occurrence Segments Combined

MPLI PRICE INCREASES TRAIL OTHER LONGER-TAIL SEGMENTS



Source: Council of Insurance Agents & Brokers Quarterly Commercial Market Survey

Market Structure Inhibiting Rate Adequacy

MPLI premium rate changes accelerated during the last year. According to the Council of Insurance Agents & Brokers (CIAB) Quarterly Commercial Market Pricing Survey, MPLI posted a 6.9% increase in renewal pricing during the first quarter of 2021 (see Table 4).

MPLI pricing momentum is likely to endure through 2021, but this level of increase falls short of changes within other liability products affected by unfavorable litigation cost trends, including the directors & officers liability and umbrella liability segments that reported strong double-digit increases in each of the last five quarters, per the CIAB survey. These segments also experienced greater recent changes in underwriting capacity and in market terms and conditions relative to MPLI.

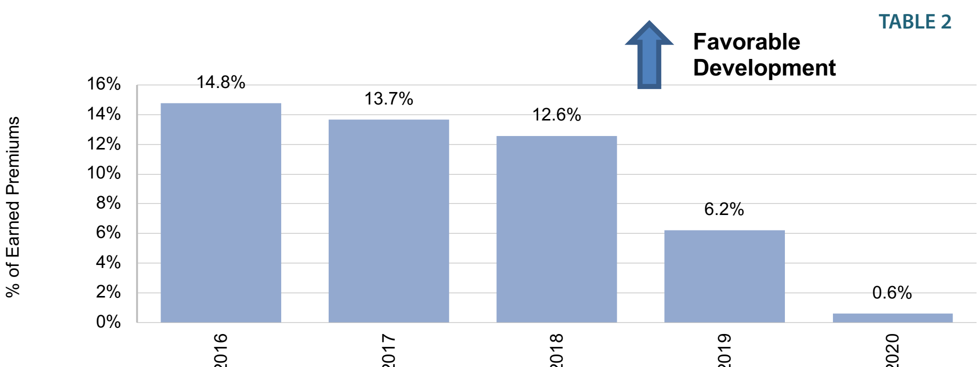
While current results indicate a need for further substantial rate increases and underwriting changes to restore profitability, unique characteristics of the MPLI segment inhibit more pronounced market changes. Particularly, more than half of MPLI net premiums are concentrated with specialty underwriters focused on physician coverage that struggle to retain policy counts and revenues as the healthcare system evolves towards physician employment by larger hospitals and medical facilities that are more likely to self-insure.

MPLI specialists largely maintain very strong capital positions that provides an ability to absorb future significant underwriting losses. A year-end 2020 review of 40 specialty MPLI writers showed a median net premium-to-surplus ratio of 0.3x, considerably more conservative than the industry figure of 0.7x, and a risk-based capital ratio well above regulatory requirements at 507% of the company action level.

Underwriting capacity reductions among MPLI specialty writers via market exits or consolidation would likely foster better market conditions, though widespread acquisition activity currently seems improbable. Market conditions have tightened more significantly in hospitals and facility coverage this year, tied to the retreat of several multi-line writers. Broker Willis Towers Watson recently indicated that rates for hospitals could rise by up to 25% through the remainder of 2021.

MPLI CALENDAR-YEAR RESERVE DEVELOPMENT/EARNED PREMIUMS

TABLE 2



Source: S&P Global Market Intelligence, Fitch. Adjusted for unusual items with AIG in 2016 and MAG Mutual in 2020.

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